

# Memorandum

**TO: HONORABLE MAYOR AND  
CITY COUNCIL**

**FROM: Del D. Borgsdorf  
Harry S. Mavrogenes**

**SUBJECT: SEE BELOW**

**DATE: May 27, 2004**

**SUBJECT: PROPOSED STATE -LOCAL GOVERNMENT TWO-YEAR BUDGET  
AGREEMENT WITH CONSTITUTIONAL AMENDMENT**

## **RECOMMENDATION**

1. That the Council support in concept the proposed State-Local Government agreement to support the passage of an alternative constitutional amendment to the Council's earlier supported Local Taxpayers and Public Safety Protection Act. This constitutional amendment would provide equivalent or better local revenue and mandate protection in conjunction with a two-year budget package, providing for \$1.3 billion contribution by local governments to the State budget deficit for no more than two-years. Starting in '06-'07 all contributions by local governments' general revenues and tax increment to the State budget would cease and the 2003-04 Motor Vehicle License Fee (VLF) Backfill Loan would be constitutionally guaranteed to be repaid.
2. That Council direct staff to identify and pursue those items that allow for flexibility in the manner in which the City and San Jose's Redevelopment Agency make their contributions to allow continuation of programs and services provided by cities and redevelopment agencies.

## **BACKGROUND**

In 2003 the LOCAL Coalition, consisting of the League of California Cities (LOCC), California State Association of Counties, (CSAC), California Redevelopment Association (CRA) and California Special Districts' Association (CSDA) sponsored a statewide ballot initiative to empower the voters to limit the ability of state government to confiscate local tax funds to finance State government. The proposed initiative in December 2003 entitled the *Local Taxpayers and Public Safety Protection Act* (the "LOCAL Initiative"), was approved by the Secretary of State and the process of circulating petitions to collect signatures to qualify the measure for the ballot began. The Council on March 30 supported the Local Taxpayers and Public Safety Protection Act. On April 16, 2004, over 1.1 million signatures were filed, an amount likely sufficient to qualify the LOCAL Initiative for the November 2004 ballot.

05-27-04

**Subject: Proposed State-Local Government Two-Year Budget Agreement with Constitutional Amendment**

Page 2

Early in 2004, Governor Arnold Schwarzenegger offered to collaborate with the LOCAL Coalition partners to secure legislative and voter approval of a proposed alternative constitutional amendment to appear on the November 2004 ballot with equivalent or better revenue and mandate protection for local agencies. In exchange for his leadership to support the campaign similar to his successful efforts regarding Proposition 57 and the alternative constitutional measure the Governor proposed and LOCAL Coalition supports is a two-year budget package that would provide for contributions of \$1.3 billion from cities, counties, special districts and redevelopment agencies each year for '04-'05 and '05-'06. The VLF backfill loan of 2003-'04 is constitutionally guaranteed to be repaid to cities and counties in 2006-'07. The proposal would also provide repayment of previously deferred mandate reimbursements to local governments over five years commencing in 2006-'07. (Please refer to the Information Memo of May 21 which details the financial impacts of the State-Local Government proposed two-year budget agreement on the City and the Redevelopment Agency).

**Major provisions in the State-Local Government proposal would result in \$1.3 billion in local government reductions in '04-'05, and '05-'06; would make the VLF relief permanent; provides revenue stability and predictability for local governments; and reforms the State-local mandate process.**

**VLF reduction would be made permanent and the "swap" of VLF backfill for an increased share of the property tax would provide revenue stability/reform to cities and counties.**

A permanent reduction of the VLF rate changes from 2 percent to .65 percent (current effective rate.) This will trigger elimination of the VLF backfill estimated to be approximately \$4 billion annually which would be replaced on a dollar-for-dollar basis with a like amount of property taxes, except for the 2-year "contribution" by cities and counties of \$700 million (\$350 million each) in '04-'05 and '05-'06. In the third year, cities and counties would receive the full amount of new property tax in exchange for the VLF backfill (\$528 million to cities). Under this plan, San Jose would receive an estimated \$16.7 million. The new property tax would grow as property tax grows in the future.

**Constitutional Amendment – greater protections than LOCAL's constitutional amendment. Both revenue protection and mandate relief.**

- Protect new local option sales tax authority enacted in 2003 as SB 566.
- Require repayment of state deferred unfunded mandates over five years, beginning in 2006-'07
- Mandates unfunded by State would automatically be repealed.

**Other LOCAL's Initiative revenue protections also included in the new proposal:**

- Requires repayment of 03-04 \$1.3 billion VLF backfill "loan" in '06-'07. Guarantees payment to cities and counties of property tax backfill and return of ¼ cent local sales tax lost due to financing the State's "triple flip" when Proposition 57 bonds are repaid.
- LOCAL's Initiative is still on the November 2004 ballot in the event the Legislature does not approve the "agreement." If legislative approval is secured, the LOCAL coalition would devote all efforts to passing of the new constitutional amendment on the November ballot. If the Legislature fails to approve the new proposed constitutional amendment, the \$1.3 billion local government contribution would be for 2004-'05 only. However, if the earlier qualifying LOCAL's constitutional amendment is the only measure on the November ballot, it would if passed by the voters, reverse the \$1.3 billion takeaway from local governments in '04-'05.

**The proposed State-Local constitutional amendment would prohibit the ability of the State to take local property tax, sales tax and VLF revenues in excess of \$1.3 billion annually beyond the next two fiscal years. If approved by the voters, the constitutional amendment would prohibit starting in '06-'07 such raids of local revenues in the future.**

For cities and counties in '04-'05 and '05-'06, the \$350 million contribution is proposed by the Administration as part of a proposal to withhold \$700 million (split 50/50 cities and counties) similar to the \$528 million VLF backfill "loan" cities made in '03-'04. Based on this formula, the City's share of the \$350 million is estimated at \$11.1 million for '04-'05 and '05-'06. Special districts would also make a \$350 million contribution while redevelopment agencies would contribute \$250 million for those same two years both on an ERAF basis. Based on this formula, the San Jose Redevelopment Agency's share is estimated at \$18.6 million for each of the two years. In '06-'07 cities statewide will receive the VLF backfill repayment (gap) of \$528 million with San Jose's share estimated to be \$16.6 million.

Contributions (millions)	VLF Backfill				
	Loss '03-'04	Loss '04-'05	Loss '05-'06	Repayment '06-'07	'07-'08
Cities	(\$528)	(\$350)	(\$350)	\$528	\$0
RDAs (ERAF)	(\$135)	(\$250)	(\$250)		\$0
Cities/RDAs Combined	(\$658)	(\$590)	(\$590)		\$0

05-27-04

**Subject: Proposed State-Local Government Two-Year Budget Agreement with Constitutional Amendment**

Page 4

In addition to the \$350 million budget cut proposed for counties there is an additional estimated \$250- \$500 million additional cost shifts and program reductions proposed by the State impacting counties.

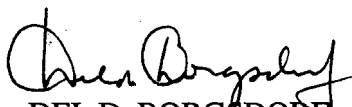
**Status:** The State-Local Government proposal which includes the new alternative constitutional amendment, must be introduced and passed by a 2/3 vote of the Legislature for the '04-'05 State budget to be in place for the start of the new Fiscal Year on July 1, 2004. To qualify the constitutional amendment for the November 2004 ballot the legislative deadline is June 24. The passage of the State-Local Government budget proposal including two year's of cuts to local governments are linked to the long term constitutional protection of local revenues and must be placed on the November 2004 ballot and approved by the voters to become effective. If voters do not approve a constitutional amendment on the November 2004 ballot, the reductions included in the '04-'05 budget would apply but for one year.

**Staff Recommendation:** Support in concept the State-Local Government proposal to provide a two-year budget agreement and passage of a constitutional amendment to protect local revenue sources and mandate reform for local agencies.

Support the enactment of measures which provide flexibility to cities and redevelopment agencies to meet their obligations while allowing the continuation of programs and services.

### **COORDINATION**

This memorandum was coordinated with Budget, the City's Legislative Representative in Sacramento, the Redevelopment Agency, and the City Attorney's Office.



DEL D. BORGS DORF  
City Manager



HARRY S. MAVROGENES  
Interim Executive Director

Attachment:

2004-'05 State Budget Summary of Impacts for the City of San Jose and the San Jose Redevelopment Agency

2004-2005 State Budget – Summary of Impacts for the City of San José and the San José Redevelopment Agency (\$ in millions)		
PROGRAMS	January Proposed	May Revision
<b>GENERAL FUND</b>		
State-Local Government Agreement (SLGA)	N/A	(\$ 11.10) <sup>1</sup>
Educational Revenue Augmentation Fund (ERAF)	(\$ 6.90)	\$ 0
<i>City of San José Additional ERAF</i>	(\$ 6.80)	\$ 0
<i>Lost ERAF Interest Earnings</i>	(\$ 0.10)	\$ 0
Vehicle License Fee (VLF) Backfill	\$ 0 <sup>2</sup>	\$ 0 <sup>3</sup>
Public Library Foundation Program	(\$ 0.03) <sup>4</sup>	(\$ 0.04)
Booking Fee Reimbursement Program	(\$ 2.50)	(\$ 2.50)
Total General Fund Impact	(\$ 9.40)	(\$ 13.64)
<b>NON-GENERAL FUND</b>		
Citizens' Option for Public Safety (COPS)	\$ 0 <sup>5</sup>	(\$ 0.60)
Proposition 42 – Traffic Congestion Relief Program (TCRP) for Local Streets and Road and Maintenance	(\$ 2.00)	(\$ 2.00)
Total Non-General Fund Impact	(\$ 2.00)	(\$ 2.60)
<b>REDEVELOPMENT AGENCY</b>		
Educational Revenue Augmentation Fund (ERAF)	(\$ 10.10)	(\$ 18.63) <sup>6</sup>
Total Redevelopment Agency Impact	(\$ 10.10)	(\$ 18.63)
<b>TOTAL FOR SAN JOSÉ AND RDA</b>	<b>(\$ 21.50)</b>	<b>(\$ 34.84)</b>

<sup>1</sup> This estimated loss of \$11.1 million is calculated based upon the City's proportionate share of Property Tax, VLF, and Sales and Use Tax revenues.

<sup>2</sup> Full funding for the VLF backfill was included in the Governor's January Proposed Budget; therefore, there was no impact on San José.

<sup>3</sup> VLF backfill would be eliminated in 2004-2005; however, the backfill amount that the City would otherwise receive would be replaced with an equal amount of Property Tax revenues shifted from schools as part of the SLGA.

<sup>4</sup> The January budget provided full funding for this program in 2004-2005. However, San José's 2004-2005 Proposed Budget anticipates a \$33,000 decrease in funding.

<sup>5</sup> The Governor proposed to fund COPS at 2003-2004 levels for 2004-2005; consequently, there was no impact from this program on the City.

<sup>6</sup> This amount represents the contribution from the San José Redevelopment Agency to the State as part of the SLGA.